

**DISTRICT OFFICES:**

5 HIGH STREET, SUITE 101  
MEDFORD, MA 02155  
(781) 396-2900

188 CONCORD STREET, SUITE 102  
FRAMINGHAM, MA 01702  
(508) 875-2900

**Congress of the United States**  
**House of Representatives**  
**Washington, DC 20515-2107**

May 7, 2002

The Honorable Harvey Pitt  
Chairman  
Securities and Exchange Commission  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C. 20545

Dear Mr. Chairman:

The Commission will have an important opportunity to strengthen analyst independence requirements and restore investor confidence when it meets on May 8 to consider proposed conflict-of-interest rules developed by the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE). Recent evidence of conflicts-of-interest at Merrill Lynch uncovered by New York Attorney General Eliot Spitzer's investigation underscore the need for regulatory reforms that protect all investors from becoming unwitting victims of recommendations driven by fees, or by investment banking relationships – as opposed to investment fundamentals.

I would like to comment on the proposed rule and request that these comments be included as part of the public record maintained by the Commission for purposes of consideration of the proposed rule. In addition, I have several questions regarding the current status of enforcement activities by the Commission and the self-regulatory organizations (SROs) in this area.

First, I would like to commend the NASD, NYSE and the Commission for its efforts to address, through the pending regulation as well as through investor education efforts, the current credibility gap created by the discovery that ostensibly objective research on Wall Street has been compromised by investment banking interests. While I strongly support ongoing rulemaking efforts, I have concerns that several of the proposed provisions under consideration may not be sufficient to resolve some deeply rooted conflicts of interest within the full-service broker-dealer industry. Therefore, I submit the following comments, which I hope will be incorporated into the final version of the rule:

**1. Restrictions on Investment Banking Department Relationship with Research Department**

Section (b)(3)(A) of the proposed rule establishes requirements for communications between investment banking and research personnel concerning research reports. While the objective sought by this provision is sound – namely, to shield analysts from pressure to modify reports to suit investment banking or management preferences – I am not convinced that a compliance officer or “gatekeeper” through which communications must pass is a practical or effective mechanism to accomplish this important goal.

I propose that the Commission and the SROs simply prohibit investment banking departments from reviewing research reports prior to publication. This prohibition should be extended to oral communications to ensure that research remains free of conflicts that could undermine its objectivity. In the case of factual questions that may arise during the development of research reports, the highly-trained and well-compensated analysts who produce these reports should be capable of resolving such questions without seeking information from their investment banking colleagues. For example, analysts can seek answers to specific factual questions by consulting corporate filings, rating agencies or subject company representatives.

## **2. Restrictions on Review of a Research Report by the Subject Company**

The proposed rule specifies conditions under which a research report can be shared with a subject company (i.e., the company that is focus of the analyst's research report). The rule mediates this process through the use of a legal or compliance department in a manner similar to the framework the rule employs for investment banking-research department interaction. I believe that research reports should not be submitted to subject companies prior to publication under any circumstances. Despite protections contemplated by the proposed rule, analysts who submit their research reports to the subjects of the research prior to publication could be pressured by the subject company to revise their research findings, particularly in cases when the analyst's firm has an existing investing banking relationship with the subject company or if the analyst's firm is seeking future investment banking services from the subject company.

In its on-site examination of full-service broker-dealers, the Commission identified, on many occasions, the existence of cozy relationships between analysts and the companies they cover. The submission of research materials to companies prior to release of the full report to the general public creates, even under the framework envisioned by the proposed rule, an unacceptable risk that subject company interests will inappropriately influence research reports to the detriment of investors.

## **3. Prohibition of Certain Forms of Research Analyst Compensation**

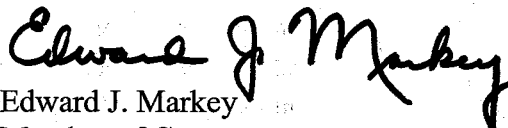
I am concerned that the rule's prohibition on analyst compensation linked to "a *specific* investment banking services transaction" (emphasis added) creates a loophole that would defeat a central objective of the entire rulemaking process, namely the removal of financial incentives to tailor analysis to suit investment bankers or company management. While the rule would appear to prevent an analyst from receiving a bonus that resulted from her firm landing a particular investment banking client, it does not appear to sufficiently de-link analyst compensation from the overall performance of the firm's investment banking department. One can envision multiple scenarios in which the proposed rule would permit analyst bonuses or other forms of compensation that result from the profitability of the firm's investment banking business. In fact, the Commission's own on-site investigation of full-service broker-dealers identified the existence of such circumstances, which appear to be permitted under the proposed rule. Specifically, at one firm the Commission examined, some of the analysts' contracts contained a provision that entitled them to receive bonuses when investment banking fees reached certain revenue targets within the business sectors covered by the analysts. This compensation was not tied to a "specific" transaction, but to an overall investment banking revenue target. Nonetheless, this linkage, which the proposed rule appears to permit, represents a dangerous loophole through which banking interests could exert improper influence upon research analysts. Therefore, I urge the Commission to tighten this provision by striking the term "specific" so that no member may pay any bonus, salary or other form of compensation to a research analyst that is based upon investment banking services.

In addition, I would also like to request information about the Commission's previous enforcement activities in the general area of securities analyst conflicts-of-interest. I therefore would appreciate the Commission's assistance and cooperation in responding to the following questions:

1. Over the past twelve months, how many enforcement inquiries has the Commission staff initiated in the area of research analyst conflicts-of-interest? When were these inquiries initiated? What are names of the firms and/or individuals involved in any of these actions assuming that such information has been made public, either by the Commission or by the subject(s) of the investigation?
2. How many of these cases have moved into the formal investigation stage? What were the names of the firms and/or individuals involved in each such formal investigation, assuming that the existence of the investigation has been made public, either by the Commission or by the subject(s) of the investigation?
3. Overall, how many total formal investigations has the Commission initiated involving research analyst conflicts-of-interest?
4. How many times has either the Commission or the Chairman turned down a request from the SEC Enforcement Division staff to initiate an inquiry or formal investigation into allegations of securities analyst conflicts-of-interest?
5. How many of the SEC inquiries/investigations into securities analyst conflicts-of-interest have resulted in civil lawsuits being brought by the Commission? How many have led to administrative proceedings? What are the names of the firms and/or individuals involved in each action?
6. When was each enforcement action initiated and when were final proceedings concluded (i.e., guilty verdict entered, settlement reached, case dismissed etc.), if the matter has in fact been concluded as of May 1, 2002?
7. What were the results of each action?
8. How many enforcement actions in the area of research analyst conflicts-of-interest are currently pending?
9. In the Commission's view, is the SEC's portion of the proposed FY 2002 supplemental appropriation before Congress sufficient to enforce statutes and regulations relating to analyst conflicts-of-interest, financial fraud and other provisions that protect investors from deceptive practices? If not, what level of funding would the Commission propose to accomplish these objectives?
10. During this same period (the last 12 months) how many investigations or inquiries into securities analyst conflicts-of-interest have been initiated by the self-regulatory organizations (SROs)? What has been the disposition of these cases?
11. How many investor complaints has the SEC received, by phone call, mail, email, or through its web-page, regarding potential securities analyst conflicts-of-interest? What has been the disposition of these complaints?

I appreciate your responses to the questions regarding previous Commission enforcement actions in the area of research analyst conflicts of interest. I also appreciate the consideration of my comments to the proposed rule and their inclusion in the public record. Please submit a response to my questions within 15 working days, or no later than May 28, 2002. Should you have any questions, please have a member of your staff contact Mr. Jeff Duncan or Mr. Mark Bayer of my staff at 202-225-2836.

Sincerely,

A handwritten signature in black ink, reading "Edward J. Markey". The signature is fluid and cursive, with the first name "Edward" and last name "Markey" clearly legible.

Edward J. Markey  
Member of Congress

cc: National Association of Securities Dealers  
New York Stock Exchange